IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1960

No. ....

AMERICAN NATURAL GAS COMPANY,
MADISON GAS AND ELECTRIC COMPANY,
MICHIGAN CONSOLIDATED GAS COMPANY,
MICHIGAN WISCONSIN PIPE LINE COMPANY,
MILWAUKEE GAS LIGHT COMPANY and
MILWAUKEE SOLVAY COKE COMPANY,

Petitioners,

vs.

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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Petitioners American Natural Gas Company, Madison Gas and Electric Company, Michigan Consolidated Gas Company, Michigan Wisconsin Pipe Line Company, Milwaukee Gas Light Company and Milwaukee Solvay Coke Company pray that a writ of certiorari issue to review the judgment of the United States Court of Claims, entered in the above-entitled case on June 8, 1960.

OPINION BELOW

The opinion of the United States Court of Claims has not yet been reported. A copy of this opinion may be found in the Appendix, *infra* pp. 21 to 33.

JURISDICTION

The judgment of the Court of Claims was entered June 8, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. § 1255(1).

QUESTION PRESENTED

Whether the sale of 1,282,734 shares of the common stock of The Detroit Edison Company in 1948 by American Natural Gas Company, pursuant to a divestment order of the Securities and Exchange Commission issued under the provisions of Section 11 of the Public Utility Holding Company Act of 1935, constitutes a compulsory or involuntary conversion of a capital asset held for more than six months within the meaning of Section 117(j) of the Internal Revenue Code of 1939, as amended.

STATUTE INVOLVED

The statutory provision involved is Section 117(j) of the Internal Revenue Code of 1939, as amended, 26 U.S.C. (1952 ed.) § 117(j), now incorporated in Section 1231 of the 1954 Code. Section 117(j) provides in pertinent part:

> "(j) **Gains and losses from involuntary conversion and from the sale or exchange of certain property used in the trade or business.**
>
> * * * * *
>
> "(2) **General rule.** If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital

assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. * * *"

STATEMENT

The stipulated facts, as adopted by the Court of Claims in its findings of fact, may be summarized as follows:

This is an action by American Natural Gas Company (hereinafter referred to as "American") and affiliated companies for the recovery of overpayments of income and excess profits taxes for the years 1944 to 1948. The amount of recovery sought is $9,472,157.80, together with interest thereon as provided by law.

The basis of this claim for tax recovery is that American in 1948 suffered a loss of $16,441,869.42 resulting from its sale of the common stock of The Detroit Edison Company.[1] American disposed of this stock pursuant to an order of the Securities and Exchange Commission issued under the provisions of Section 11 of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79k, which directs the Commission to effect the simplification of corporate structures and the integration of public utility holding company systems. The petitioners claim that this loss on the sale of

1. There is disagreement between the parties as to the amount of the loss suffered by American, based upon differing computations of the tax basis of the Detroit Edison stock. The parties by stipulation deferred consideration of the tax basis question until decision of the involuntary conversion issue. Since the Court of Claims dismissed the petition on the involuntary conversion issue, the basis question has not as yet been resolved. For present purposes the respondent's computation of the tax loss will be used.

stock is a loss from the "compulsory or involuntary conversion" of a capital asset, within the meaning of Section 117(j) of the Internal Revenue Code of 1939, as amended, and that under the provisions of that section the loss is deductible as an ordinary loss in computing American's net income.

The circumstances of the sale of the stock by American are as follows: After the Public Utility Holding Company Act of 1935 (hereinafter referred to as the "Act") became effective, American[2] and other companies in its holding company system filed registration statements with the Securities and Exchange Commission pursuant to Section 5 of the Act. American itself was a "holding company," as defined in Section 2 of the Act, and its assets included 1,289,205 shares, constituting 20.3%, of the common stock of Detroit Edison, an electric utility company (Findings 2, 3).[3]

Under Section 11(a) of the Act the Commission was required to examine the corporate structures of every registered holding company and the relationships among the companies in each holding-company system to determine the extent to which such corporate structures might be simplified, unnecessary complexities eliminated, voting power fairly and equitably distributed, and properties and business confined to those necessary or appropriate to the operations of an integrated public-utility system. Section 11(b)(1) of the Act imposed upon the Commission the duty

2. American was formerly known as American Light & Traction Company and is referred to by that name in the orders of the Securities and Exchange Commission quoted in the record. The change in name from American Light & Traction Company to American Natural Gas Company was made effective as of June 15, 1949.

3. References are to the paragraphs in the findings of fact, reported by the trial commissioner and adopted by the Court of Claims, which are submitted as part of the record in this case (R. 61-87).

to require by order that each registered holding company take such action as the Commission found necessary to limit the operations of the holding-company system to a single integrated public utility system.

Acting pursuant to Section 11(a) of the Act, the Commission on March 8, 1940, issued an order for a hearing directed to American and other holding companies forming a part of the system, asserting that the system was not confined in its operation to a single integrated public-utility system (Finding 4). Thereafter, in hearings and briefs American asserted its right and desire to retain its stock interest in Detroit Edison (Findings 5, 7).

Notwithstanding American's contentions, the Commission on August 5, 1941, issued a decision and order directing the simplification of the holding-company system and requiring, among other things, that American dispose of its Detroit Edison stock (Finding 8). The Commission's order of that date stated:

> "American * * * shall dispose of its interests in * * * The Detroit Edison Company, * * * and in the properties and assets owned or operated thereby." (Finding 8)

The order further directed the companies to proceed with due diligence to comply with its provisions and to make application to the Commission for the entry of further orders necessary or appropriate for that purpose. The Commission expressly reserved jurisdiction to enter such orders as might be necessary or appropriate to carry out the provisions of the August 5, 1941 order.

Thereafter, the companies in the holding-company system filed a series of applications with the Commission requesting its approval of various divestments required by the August 5 order, and a number of divestments within the

system were accomplished by virtue of supplemental orders issued by the Commission. Various proposals for methods of divesting the Detroit Edison stock were made and considered, but it was not until 1947 that a plan was finally approved by the Commission to accomplish that result. During the interim period, the Commission on several occasions threatened resort to Section 11(d) of the Act if plans of divestment were not promptly presented or amended to conform to the Commission's views (Findings 11, 13). Under Section 11(d), the Commission may apply to a court to appoint it as trustee to take jurisdiction and possession of a holding company's assets.

On December 30, 1947, the Commission issued an opinion and order approving a plan of divestment of the Detroit Edison stock. It directed the disposition of the shares of Detroit Edison owned by American by public sales and by distribution to stockholders during the year 1948.[4] The Commission concluded that the "foregoing divestments are specifically required by our outstanding order of August 5, 1941" (Finding 23).

Accordingly, American sold 450,000 shares of its Detroit Edison stock in January, 1948, 450,000 shares in April, 190,000 shares in August, and 192,734 shares in November. The balance of this stock was distributed to the shareholders of American. Each of the sales of the four blocks of stock was made pursuant to a Commission order which recited that the sale was "necessary or appropriate to the integration or simplification of the holding company system of which American Light is a member" (Findings 25, 26).

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4. In anticipation of the final order, the sale of the first 450,000 shares of stock had been authorized and directed by order issued November 19, 1947 (Finding 22).

The net proceeds from these sales of the Detroit Edison stock held for more than 6 months totaled $24,890,228.55. Since the tax basis of these shares was at least $41,338,260.02, American suffered a tax loss of $16,441,869.42 as a result of the sale of Detroit Edison stock pursuant to orders of the Commission, as detailed above (Finding 32).

In 1952 American and the other petitioners herein filed a timely claim for refund of income taxes for 1948, contending that the loss incurred by American was a loss from the compulsory or involuntary conversion of capital assets held for more than 6 months within the meaning of Section 117(j) of the Internal Revenue Code of 1939. In addition, claims for the refund of income taxes for 1947 and 1946 and excess profits taxes for 1945 and 1944 were filed, all of which were dependent upon the determination of the 1948 claim. All of these claims for refund were denied by the Director of Internal Revenue in 1954 and 1955 (Finding 30).

This action was commenced in the United States Court of Claims on January 3, 1956, under the provisions of 28 U.S.C. § 1491(2). After the parties agreed to a stipulation of facts, the trial commissioner of the court reported his findings of fact on May 12, 1959. On June 8, 1960, the Court of Claims handed down a decision dismissing the petition of the plaintiffs. In its opinion the court concluded that:

> "There can be no doubt that the conversion of the property was under compulsion, and we think it was involuntary. * * *."

Nevertheless, the court held that the transaction did not come "within the sort of compulsory or involuntary conversions described in the limiting clause, which is enclosed in parentheses" in Section 117(j).

REASONS FOR GRANTING THE WRIT

1. The decision of the Court of Claims in this case cannot be reconciled with this Court's decision in *Commissioner* v. *Gillette Motor Transport, Inc.*, 364 U.S. 130 (June 27, 1960), which came down three weeks after the decision below, or with the decision of the United States Court of Appeals for the Eighth Circuit in *Midwest Motor Express, Inc.* v. *Commissioner*, 251 F.2d 405 (1958), cert. den. 358 U.S. 875. The *Gillette* and *Midwest* cases, like this case, involved the interpretation of Section 117(j) of the Internal Revenue Code of 1939. Specifically, the courts in all three cases were concerned with the following language in Section 117(j):

> "* * * compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets * * *."

Section 117(j), now Section 1231 of the 1954 Code, provides that net gains from "involuntary conversions" of capital assets shall be treated as capital gains and that net losses from such conversions shall be treated as ordinary losses. This provision and Section 112(f) are relief provisions.[5] They were intended to postpone or ameliorate the tax consequences of transactions which result in the conversion of capital assets under a compulsive order of some governmental or quasi-governmental body. As the Court of Appeals for the Fourth Circuit recently stated in

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[5] Section 112(f) of the 1939 Code, now Section 1033 of the 1954 Code, provides for the non-recognition of gains resulting from compulsory or involuntary conversions of capital assets. The "involuntary conversion" language of Sections 112(f) and 117(j) is almost identical.

Stewart Brothers v. *Commissioner*, 261 F. 2d 580, 582 (1958), the "obvious purpose" of the involuntary conversion provisions of the Code is to provide tax relief:

> "• • • when [the taxpayer] does not liquidate his holding of his own will but parts with it involuntarily *by virtue of superior governmental power*, or loses it through circumstances over which he has no control." (Emphasis supplied)

In the present case, American was required by Commission order to divest itself of its holdings of Detroit Edison stock. Because the market value of that stock was relatively low at the time, American suffered a large tax loss on the sale. Having virtually no capital gains against which to offset the loss, American loses the entire tax effect of the loss unless Section 117(j) applies, in which case the loss may be offset against ordinary income. It is our contention that this is the very type of involuntary conversion Section 117(j) was intended to cover.

The *Gillette* and *Midwest* cases involved the question whether, when the Director of the Office of Defense Transportation had taken possession of certain motor carriers under Presidential order during World War II, an award by the Motor Carrier Claims Commission to the carriers as a result of this Government action constituted an involuntary conversion within the meaning of Section 117(j). This Court and the Court of Appeals both held that the award was not entitled to capital gains treatment under Section 117(j) because it was no more than a rental or use payment, and there was thus no "conversion" of capital. Both courts were of the view, however, that the Government action involved fully satisfied the parenthetical clause of Section 117(j), namely, "(as a result of . . . seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof)."

In the present case the Court of Claims adopted a precisely contrary interpretation of the parenthetical clause of Section 117(j). The court concluded, as the stipulated facts required, that the transaction was compulsory and involuntary and that the sale of the Detroit Edison stock was a "conversion" of a capital asset. However, the Court of Claims held that the parenthetical clause of Section 117(j) was not satisfied by the Government action taken and in effect ignored the significance of the action threatened by the Commission under Section 11(d) of the Act.

That section authorizes the Commission to apply to a court to take "exclusive jurisdiction and possession of the company or companies and the assets thereof." The court may appoint the Commission as trustee of "the assets so possessed," and the Commission has the "power to dispose of any or all of such assets." The record shows that the Commission threatened on a number of occasions to take such action under Section 11(d) if the Detroit Edison stock was not promptly divested. It further shows that American disposed of that stock pursuant to the August 5, 1941 order and the threats of Commission action under Section 11(d).[6]

Petitioners submit that there is no substantive difference between Government control of motor carriers for the purpose of insuring compliance with a War Labor Board decision, as in *Gillette* and *Midwest*,[7] and Government control

6. The parenthetical clause of Section 117(j) not only includes the terms "seizure," "requisition" and "condemnation," but it also applies to an involuntary conversion as a result of the "threat or imminence thereof".

7. The Executive Order involved in *Gillette* and *Midwest* clearly had as it purpose the enforcement of a War Labor Board directive order. See Executive Order No. 9462, 3 C.F.R. (1943-1948 Comp.) p. 322. The operations order provided that possession by the United States was "not exclusive" and that the United States would assert "only such control over the properties in its limited possession as may be necessary to accomplish the purposes" of the Executive Order. (251 F. 2d at 407)

of a public utility holding company for the purpose of insuring compliance with a Securities and Exchange Commission order, as in the present case. Since the former action constituted a "seizure" or "requisition" within the meaning of the parenthetical clause of Section 117(j), the decision of the Court of Claims to the effect that the threat or imminence of Commission action under Section 11(d) does not satisfy the parenthetical clause is clearly in error and contrary to the decisions in the *Gillette* and *Midwest* cases.

2. Apart from the specific inconsistency with this Court's decision referred to above, this case presents an important recurring question as to the interpretation of the kind of "superior governmental power" (to quote from the *Stewart* case) that qualifies a transaction for involuntary conversion treatment under Sections 117(j) and 112(f). The parenthetical clause of these sections refers generally to three types of Government action, namely "seizure, * * * requisition or condemnation or the threat or imminence thereof." However, these terms are by no means words of art.[8] Different interpretations of the terms "seizure," "requisition," and "condemnation" in the involuntary conversion context have been made by this Court in *Commissioner* v. *Gillette Motor Transport, Inc.*, 364 U.S. 130 (1960), by the Eighth Circuit in *Midwest Motor Express, Inc.* v. *Commissioner*, 251 F.2d 405 (1958),

8. The term "condemnation," for example, is used in the federal statutes to refer to actions involving misbranding or adulteration of foods, drugs or cosmetics (21 U.S.C. §334), misbranding of wool (15 U.S.C. §68c), or furs (15 U.S.C. §68g), adulterated seeds (7 U.S.C. §1595), war materials intended for unlawful export (22 U.S.C. §404), and prizes in admiralty (28 U.S.C. §1333). And the term "requisition" has been defined simply as "a demand in writing, or formal request or requirement" (Black's Law Dictionary (4th ed. 1951)) or a "formal demand for the performance of an obligation" (Webster's New International Dictionary (2d ed. 1957)).

by the Third Circuit in *Dear Publication & Radio, Inc.* v. *Commissioner*, 274 F.2d 656 (1960) and by the Court of Claims in the present case.

In *Gillette* this Court agreed that an executive order permitting the Director of the Office of Defense Transportation to take limited possession and assume control of certain motor carriers was a "seizure" or "requisition" under Section 117(j). The Court stated that these terms "equally cover instances in which the Government takes a fee or damages or otherwise impairs the value of physical property" (364 U.S. at 136). No requirement of the acquisition of the title to the property by the Government was imposed by the Court. This Court in *Gillette* recognized that title to the properties remained in the motor carrier and that the Government action involved was that the United States had "deprived" the respondent of the "right to determine freely what use to make of its transportation facilities" (364 U.S. at 133). On the other hand, the Court of Claims in the present case held that only the "exercise of the power of eminent domain," whereby a public or quasi-public corporation takes the property *for its own use*, would be sufficient Government action under Section 117(j).

In *Dear Publication & Radio, Inc.* v. *Commissioner*, *supra*, the Court of Appeals for the Third Circuit held that the sale of stock by a taxpayer to the other principal shareholder in a corporation after judicial proceedings had been commenced by the other shareholder under the New Jersey "deadlock" statute was not an involuntary conversion under threat of requisition or condemnation. The court emphasized that it was the presence of a private controversy and the absence of Government action that precluded the extension of involuntary conversion relief to the taxpayer. However, in referring to the meaning of

"requisition" and "condemnation" in the involuntary conversion provision of the Code, the Court of Appeals cited with approval (274 F. 2d at 660) the decision, *Mitsubishi Shoji Kaisha* v. *Societe Purfina Maritime*, 133 F.2d 552, 555 (9th Cir. 1942), cert. den. 318 U.S. 781, which indicated that a "requisition" may involve nothing more than direction by the Government to the owner of property to use or dispose of it in a particular manner required by the public interest. This, of course, would embrace the situation here presented. Petitioners accordingly submit that the decision of the Court of Claims is also inconsistent with the recent opinion of the Court of Appeals for the Third Circuit in the *Dear Publication* case.

Thus, a determination by this Court of a case squarely presenting the question as to the kind of Government action contemplated by the involuntary conversion provisions of the Code is essential in light of the conflicting views of this Court, the courts of appeals and the Court of Claims.

3. The characterization by the Court of Claims of divestments under the Public Utility Holding Company Act is inconsistent with past decisions of this Court. In the present case the Court of Claims held that in ordering the sale of stock the Securities and Exchange Commission was not exercising the power of eminent domain but was merely exercising the constitutional power to regulate interstate commerce. The court likened the Public Utility Holding Company Act to legislation aimed at public nuisances, such as narcotics, whiskey, firearms and unsafe or unsanitary property. It then cited a number of cases where it has been held that no compensation is required under the Fifth or the Fourteenth Amendment when there is legislation aimed at such public nuisances.

In the first place, the premise of the Court of Claims,

that American's tax claim was the same as a Fifth Amendment just compensation claim, conflicts with the decision of this Court in *Commissioner* v. *Gillette Motor Transport, Inc.*, 364 U.S. 130 (1960). There this Court rejected a similar assertion by the motor carrier as irrelevant to the question before it, when it stated:

> "But the fact that something taken by the Government is property compensable under the Fifth Amendment does not answer the entirely different question whether that thing comes within the capital-gains provisions of the Internal Revenue Code." (364 U.S. at 133).[9]

Accordingly, the contention of the Court of Claims that Section 117(j) does not apply because American received the fair market value for the stock sold begs the question. In practically all requisition or condemnation situations under Section 117(j) the taxpayer has been compensated for the fair value of his property, thereby satisfying the constitutional just compensation requirement, but he may have a *tax* gain or *tax* loss depending on the tax basis of the property converted.

Secondly, the characterization of American's ownership of the Detroit Edison stock as a public nuisance is in direct conflict with two decisions of this Court interpreting Section 11(b) of the Public Utility Holding Company Act. In *North American Company* v. *Securities and Exchange Commission*, 327 U.S. 686, 709-10 (1946) the Court, in upholding the constitutionality of Section 11(b) (1), held that

9. Thus, in *United States* v. *Caltex*, 344 U.S. 149, 155 (1952) this Court denominated an order by an army commander to evacuate premises slated for demolition as a "requisition," but it held that no compensation was required under the Fifth Amendment. So far as the language and purpose of Section 117(j) are concerned, the "requisition" involved in *Caltex* seems to be a clear case of involuntary conversion under Section 117(j).

the just compensation requirement of the Fifth Amendment had been satisfied by the safeguard in the Act that a plan of divestment be "fair and equitable" to those affected. Moreover, this Court suggested that an unfair plan of divestment might constitute an unconstitutional taking without just compensation. Yet this Court has consistently recognized that no just compensation at all is required when Government action results in the destruction of a public nuisance. See *United States* v. *Caltex, Inc.*, 344 U.S. 149 (1952); *Samuels* v. *McCardy*, 267 U.S. 188 (1925). In *American Power & Light Co.* v. *SEC*, 329 U.S. 90, 107 (1946) this Court again emphasized that the statutory standards of the Public Utility Holding Company Act prevent the taking of property rights without just compensation. The holdings of this Court in these cases dealing specifically with divestments under the Act are directly opposed to the Court of Claims' treatment of stock ownership by public utility holding companies as public nuisances.

Moreover, the reliance of the Court of Claims upon the fact that this Court held in the *North American* case that the Public Utility Holding Company Act was enacted under the authority of Congress to regulate interstate commerce does not answer the separate and distinct question whether the order of divestment by the Commission was an involuntary conversion under Section 117(j). This Court has repeatedly held that "takings" under the power of eminent domain may occur under any of the enumerated powers of Congress, such as the interstate commerce power (*Monongahela Navigation Co.* v. *United States*, 148 U.S. 312, 337 (1893)), the power to raise armies (*United States* v. *Gettysburg Electric Ry. Co.*, 160 U.S. 668, 681-3 (1896)), and the power to legislate for the District of Columbia (*Shoemaker* v. *United States*, 147 U.S. 282, 298 (1893)). A "taking"

under the eminent domain power is merely a means to accomplish one of the enumerated powers of Congress. *Berman* v. *Parker*, 348 U.S. 26, 33 (1954).

Lastly, the decision of the Court of Claims in this case has injected confusion with respect to the nature of "takings" by the Government. The Court of Claims stated that a "requisition or condemnation" meant the taking of property "for the use of the taker" and that the Commission order of the sale of stock did not have the characteristics of such a "taking." However, as this Court recognized in *Berman* v. *Parker*, 348 U.S. 26, 33-4 (1954), the Government may take property solely for a "public purpose" and not for its own use. In *United States* v. *General Motors Corp.*, 323 U.S. 373, 378 (1945) this Court pointed out that "the deprivation of the former owner rather than the accretion of a right or interest to the sovereign constitutes the taking." In *United States* v. *Powee Coal Co.*, 341 U.S. 114, 120 (1951), Mr. Justice Reed pointed out in concurrence that "takings" can assume various forms, one of which is where "the Government, for public safety or the protection of the public welfare, 'takes' the property in the sense of assuming the responsibility of its direction and employment for national purposes."

4. The question presented in this case concerns the interpretation of provisions of the federal tax laws in a factual situation that involves substantial amounts of tax losses. Petitioners believe that no federal statute has had an impact upon the corporate ownership of assets greater than the Public Utility Holding Company Act of 1935. Since 1935 the Securities and Exchange Commission has assumed jurisdiction under the Act over 2,387 companies.[10] In 1958 the Commission reported that 921 com-

10. 25 SEC Ann. Rep. (1960) p. 123.

panies with assets aggregating approximately $15.3 billion at their respective dates of divestment have been divested by their respective parents since the Act was passed.[11] In a report of the Commission, issued on January 6, 1960, it noted a number of divestments still before the Commission under Section 11(b) of the Act.[12] For example, it reported that the Commission recently ordered the Cities Service Company to dispose of its holdings in a subsidiary under Section 11(b)(2); that pending before the Commission is a plan of disposition of the gas properties of Blackstone Valley Gas & Electric Co.; that proceedings are pending under Section 11(b)(1) with respect to the retainability by The Columbia Gas System, Inc. of the properties of ten companies, with respect to the retainability by the New England Electric System of its gas properties, and with respect to the retainability of a subsidiary by Utah Power & Light Co.; that the Commission is currently considering the retainability of various gas and transportation properties owned by Middle South Utilities, Inc., of oil, real estate and gas businesses owned by National Fuel Gas Co., and of gas and electric facilities owned by Delaware Power & Light Co.[13]

In addition to the substantial amount of tax recovery in issue in the present case, the petitioners have been informed of at least two other tax claims involving precisely the same issue. By agreement with the Commissioner of Internal Revenue, the statute of limitations concerning claims of the Iowa-Illinois Gas and Electric Company, as successor agent of The United Light and Railways Company and affiliated companies, in the amount of $9,593,536.94 plus interest, has been suspended pending final decision of the present case.

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11. 23 SEC Ann. Rep. (1958) p. 103.
12. 25 SEC Ann. Rep. (1960) p. 122.
13. 25 SEC Ann. Rep. (1960) pp. 122-3.

The attorneys for the Koppers Company, Inc. have informed the petitioners of claims of that company for tax recovery of approximately $10,000,000 involving the identical issue. In light of the substantial number of divestments that have been ordered by the Securities and Exchange Commission and that are still pending before the Commission, it is reasonable to conclude that this issue will be presented in numerous other cases.

Congress recognized the significant relationship between the federal tax laws and divestments under Section 11 of the Public Utility Holding Company Act as early as 1938. In that year Mr. Justice Douglas, then Chairman of the Securities and Exchange Commission, appeared before the Senate Finance Committee urging certain tax relief measures in the case of holding company divestments. He testified with respect to these Section 11 orders by the Commission:

> "But, Mr. Chairman, since this is a compulsory transaction that they are going to be engaged in from now on, it does not seem to us fair and equitable for the government to force them to do this and at the same time to collect taxes as the result of their doing it. * * * We down at the Commission do not desire to put the gun at the head of a utility company and say, 'Transfer these,' and then to have another branch of the Federal government collect $2,000,000, or $1,000, or $250,000 as the result of doing what we are forcing it to do."[14]

In response to this testimony, Congress in 1938 amended the income tax laws to provide specifically for the nonrecognition of gains or losses in the case of certain divestments ordered by the Commission under the Act. These provisions were found in Supplement R (Sections 371-373)

14. Hearings before Senate Finance Committee on H.R. 9682, 75th Cong. 3rd Sess., part 4, p. 73.

of the Internal Revenue Code of 1939. Subsequently, in the Revenue Act of 1942 Congress amended Supplement R to expand its tax relief to the sale of assets at a *gain* resulting from Commission orders under Section 11(b) of the Act, noting that such divestments are "compulsory transactions."[15] At the same time, however, Congress provided that *losses* from such compulsory transactions should be recognized immediately, stating that:

> "* * * the recognition of the loss will be determined by the provisions of the Internal Revenue Code outside of Supplement R."[16]

In the same Revenue Act of 1942 Congress enacted Section 117(j), which provided for the first time that losses from "compulsory or involuntary conversions" of capital assets shall be treated as losses fully deductible from ordinary income.

Thus, since 1938 the Internal Revenue Code has contained specific provisions granting involuntary conversion-type tax relief to gain transactions resulting from divestments required by the Commission under the Public Utility Holding Company Act. However, since 1942 Congress has provided that losses arising under identical circumstances should be treated under "provisions of the Internal Revenue Code outside of Supplement R." This is the first case presenting the issue whether Congress intended Section 117(j) as the vehicle for tax relief in such circumstances. The question is of great significance in light of the many divestments that have already taken place under the Public Utility Holding Company Act. The question will certainly continue to arise in the future since the

15. H.R. Rep. No. 2333, 77th Cong., 2nd Sess. 1942, p. 123 (1942-2 Cum. Bull. 372, 463).

16. H.R. Rep. No. 2333, 77th Cong., 2nd Sess. 1942, p. 123 (1942-2 Cum. Bull. 372, 464).

Commission is continuing to order divestments under the Act. Supplement R of the 1939 Code, governing gain transactions under the Act, is an integral part of the current tax laws as Sections 1081 to 1083 of the Internal Revenue Code of 1954. 26 U.S.C. §1081-3. We submit that it is necessary for this Court to finally determine whether Section 117(j), now Section 1231 of the 1954 Code, is the provision governing the treatment of loss transactions resulting from divestments under the Act.

In short, it is essential that this Court review the decision of the Court of Claims in the present case or, in the alternative, to vacate the decision of that court with directions to reconsider the matter in light of this Court's decision in the *Gillette* case. Not only does the case present questions of substantial significance under the federal tax laws, but it deals with fundamental principles at the very heart of the Public Utility Holding Company Act.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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September, 1960.

APPENDIX

IN THE

United States Court of Claims

No. 3-56

(Decided June 8, 1960)

AMERICAN NATURAL GAS COMPANY, MADISON GAS AND ELECTRIC COMPANY, MICHIGAN CONSOLIDATED GAS COMPANY, MICHIGAN WISCONSIN PIPE LINE COMPANY, MILWAUKEE GAS LIGHT COMPANY, and MILWAUKEE SOLVAY COKE COMPANY v. THE UNITED STATES.

Mr. Arthur R. Seder, Jr., for plaintiffs. *Messrs. Middleton Miller, J. Bean Vail, Jr., Robert R. Frei, Jules M. Perlberg*, and *Sidley, Austin, Burgess & Smith* were on the briefs.

Mr. Jerome S. Hertz, with whom was *Mr. Assistant Attorney General Charles K. Rice*, for defendant. *Messrs. James P. Garland* and *Philip R. Miller* were on the brief.

OPINION

WHITAKER, *Judge*, delivered the opinion of the court:

Plaintiffs sue to recover an alleged overpayment of income and excess profits taxes for the years 1944 to 1948, both inclusive, in the amount of $9,472,157.80, plus interest allowed by law. Under orders of the Securities and Exchange Commission the predecessor of plaintiff American Natural Gas Company, both hereinafter referred to as

"American", sold its stock in The Detroit Edison Company in the year 1948 at a loss. Plaintiffs, who filed consolidated tax returns for the years in question, allege that they are entitled to deduct this loss from ordinary income; whereas, the Commissioner of Internal Revenue allowed the loss only to the extent of the capital gains.

The issue presented is whether or not plaintiffs are entitled to deduct from their ordinary income the full amount of the loss.[1]

They are entitled to do so, if at all, only by virtue of section 117(j) of the Internal Revenue Code of 1939, as amended by the Revenue Act of 1942. This section reads:

> (j) Gains and losses from involuntary conversion and from the sale or exchange of certain property used in the trade or business.
>
> * * * * * *
>
> (2) General rule. If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power or requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. * * *

1. If they are, they sustained a net operating loss in 1948, which they will be able to use as a carryback to the preceding taxable years to offset or reduce the income for those years and, hence, to recover some or all of the taxes previously paid for those years.

Plaintiffs say that American sold its stock in the Detroit Edison Company under compulsion of an order of the Securities and Exchange Commission, and that the loss on the sale, therefore, comes within the provision of the statute relating to a "compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property * * *." Such a loss is deductible from ordinary income.

There can be no doubt that the conversion of the property in question was under compulsion, and we think it was involuntary, but we do not think it comes within the sort of compulsory or involuntary conversions described in the limiting clause, which is enclosed in parenthesis. It can only come within that involuntary conversion which is the result of a requisition of property or a condemnation thereof, or the threat or imminence of requisition or condemnation, and we do not think it was the result of either. American's ownership of the property had become unlawful after the passage of the Public Utility Holding Company Act, and, because it was unlawful, it was ordered to dispose of it. Defendant did not take it at all, neither for its own use nor for the use of another, nor did it threaten to do so.

This will become apparent from a reading of the Public Utility Holding Company Act of 1935 (49 Stat. 803), and the circumstances surrounding the sale.

This Act directed the Securities and Exchange Commission to require all utility holding companies to simplify their corporate structure and to eliminate therefrom all holdings which were not necessary or appropriate to the operation of an integrated public utility system. Section 11(a) of the Act required the Commission "to examine the corporate structure of every registered holding company and sub-

sidiary company thereof, the relationships among the companies in the holding-company system of every such company and the character of the interests thereof and the properties owned or controlled thereby to determine the extent to which the corporate structure of such holding-company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public-utility system."[2]

Under section 11(b)(1) the Commission was charged with the duty "to require by order, after notice and opportunity for hearing, that each registered holding-company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system; * * *."

Any order made thereunder was made subject to judicial review. Under subsection (c) of section 11 it was required that any order issued should be complied with within one year, subject to the right in the Commission to extend the time. Under subsection (d) of section 11 the Commission was authorized to apply to a court for the enforcement of its orders.

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2. An integrated public utility system was defined as one which "may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair * * * the advantages of localized management, efficient operation, and the effectiveness of regulation; * * *."

Acting pursuant to the authority therein granted, the Securities and Exchange Commission on March 8, 1940 issued an order for a hearing directed to American and the other holding-companies forming a part of the system. The order recited that its system was not confined to a single integrated public utility system and, accordingly, ordered that hearings be commenced and that the companies be required to file an answer. The companies answered, asserting their right to continue their operations under their present system, but they nevertheless expressed a willingness to cooperate with the Commission, to avoid controversy, and, so, they proposed a plan for the disposition of certain properties of the system, and the grouping of the remaining assets into three geographical areas.

On June 13, 1941, the Commission issued a statement of tentative conclusions holding that the system as then constituted did not meet the standards of integration set out in the Public Utility Holding Company Act of 1935, and that, among other things, American's ownership of stock in the Detroit Edison Company must be disposed of. The Commission directed that the companies show cause why an order should not be entered in conformity therewith. The companies answered, vigorously protesting the Comission's proposed order, but the Commission, notwithstanding, on August 5, 1941, issued its decision directing, among other things, that American dispose of its Detroit Edison Company stock. The order provided that the companies should proceed "with due diligence to comply with the foregoing order, and shall make application to the Commission for the entry of any further orders necessary or appropriate for that purpose." Jurisdiction was retained for the entry of such orders as might seem necessary and appropriate.

The companies submitted their first plan on November 1,

1944, some three years later, and applied for its approval, but this was refused by the Commission on June 2, 1945.

On June 26, 1947, the companies filed another plan, known as Application 31. On September 2, 1947, the Commission delivered its opinion, in which it stated that the plan appeared to be deficient in not providing for prompt compliance with the original order of August 5, 1941. Thereupon, the companies filed an amendment to the plan on September 18, 1947. Hearings on this amended application were ordered.

On October 28, 1947, the companies filed a second amendment to the application, in which it was stated that the Detroit Edison stock would be disposed of by December 31, 1948, and proposed an immediate sale of 450,000 shares thereof. On November 19, 1947, the Commission issued an order in which it authorized the sale of the 450,000 shares of Detroit Edison stock.

Then, on December 30, 1947, the Commission entered an order approving application No. 31, as amended. It directed, among other things, that the Detroit Edison stock be disposed of, 450,000 shares in December 1947, 400,000 shares in May 1948, and 250,000 shares in October 1948, the balance to be distributed to the stockholders as dividends. In the meantime American had received a stock dividend from Detroit Edison of 128,920½ shares, the Commission ordered that these shares be disposed of in conformity with its order of August 5, 1941.

American sold 450,000 shares of the Detroit Edison stock in January 1948 at a price of $19.06 a share; in April 1948 it sold another 450,000 shares at a price of $19.73 a share; in August 1948 it sold 190,000 shares at a price of $20.01 a share; and in November 1948 it sold 192,734 shares at a

price of $19.546 a share. The balance of the stock was distributed to its stockholders.

Plaintiffs say these sales were involuntary conversions which resulted from "an exercise of the power of requisition or condemnation or the threat or imminence thereof," as these words are used in section 117(j), *supra*. Plaintiffs concede that in order to receive the tax benefits of section 117(j), a compulsory or involuntary conversion must be one which results from one of those things mentioned in the parenthetical clause of that section, in this case, requisition or condemnation or the threat thereof; but they argue, first, that the order of divestment issued by the Securities and Exchange Commission was an exercise of the power of requisition or condemnation; or, in the alternative, they say, since the Act empowered the Commission to apply to a court to appoint a receiver to take over the assets of the company and enforce the order, that the order amounted to a threat to requisition or condemn the property.

We cannot agree. The order of the Securities and Exchange Commission was neither a requisition nor a condemnation, nor the threat of either. It was nothing more than an order by the Commission for plaintiffs to dispose of property the possession of which by plaintiffs was prohibited by the Public Utility Holding Company Act. It was an order for plaintiffs to comply with the law. The Act required that "the properties and business thereof [of a public utility system] be confined to those necessary or appropriate to the operations of an integrated public utility system"; the Commission thought that American's ownership of the Detroit Edison Company stock was not necessary for this purpose; and, so, it required American to dispose of that the possession of which by it was no longer lawful.

By no means can this be considered an exercise of the power of eminent domain. The United States did not take the property; it did not take it for public use or for any use at all. On the contrary, in ordering the sale of the stock, Congress was exercising, through the Securities and Exchange Commission, its constitutional power to regulate interstate commerce. The Supreme Court has held that the Public Utility Holding Company Act of 1935, which authorized such an order, was a valid exercise of such power. *American Power & Light Co.* v. *Securities and Exchange Commission*, 329 U.S. 90; *North American Co.* v. *Securities and Exchange Commission*, 327 U.S. 686; *Electric Bond & Share Co.* v. *Securities and Exchange Commission*, 303 U.S. 419.

The purpose of the Act was to eliminate the evils then existing in public utility holding companies, and to protect the public from the abuses inherent in them as they were then constituted. It was an Act to promote the public welfare. It was no part of its purpose to condemn or to requisition the companies' property. The Supreme Court, in *North American Company* v. *Securities and Exchange Commission*, *supra*, said that "Congress enacted the Public Utility Holding Company Act of 1935, 49 Stat. 803, in order to correct grave abuses which it had found in the use of the holding-company device in the nation's electric and gas utilities industries." It further said at pp. 705-6:

> This broad commerce clause does not operate so as to render the nation powerless to defend itself against economic forces that Congress decrees inimical or destructive of the national economy.
>
> * * * * *
>
> Congress in § 11(b)(1) of the Public Utility Holding Company Act was concerned with the economic evils resulting from uncoordinated and unintegrated public utility holding company systems. These evils

were found to be polluting the channels of interstate commerce and to take the form of transactions occurring in and concerning more states than one. Congress also found that the national welfare was thereby harmed, as well as the interests of investors and consumers. These evils, moreover, were traceable in large part to the nature and extent of the securities owned by the holding companies. Congress therefore had power under the commerce clause to attempt to remove those evils by ordering the holding companies to divest themselves of the securities that made such evils possible.

In the exercise of its regulatory powers Congress, of course, must act within the limits imposed by the Constitution. If it exceeds these limits by taking private property without due process, then the regulatory statute is invalid. In the *North American* case, *supra*, the petitioner argued that section 11(b)(1) of the Public Utility Holding Company Act of 1935 was unconstitutional, in that it amounted to a taking of private property. The Court answered this at 327 U.S. 709 by stating:

> • • • there is no basis here for assuming that in limiting the scope of North American's operations there will be dispositions of securities for inadequate considerations, thereby raising a question as to whether there is a destruction of these values without just compensation. The Act does not contemplate or require the dumping or forced liquidation of securities on the market for cash. Under §§ 11(d) and 11(e) of the Act, any divestment or reorganization plan must meet the standards of fairness and equitableness. In many instances this may involve no more than a distribution of the securities among the existing shareholders of the holding company. But should securities be sold for cash, speculation as to unfavorable market conditions cannot undermine the validity of § 11(b)(1). • • •

There is no contention that in the case at bar the securi-

ties had to be sold for less than their market value at the time of the sale.

The Public Utility Holding Company Act does not differ in principle from many other statutes that prohibit the possession of things which the legislative authority considers inimical to the public welfare: for instance, narcotics, whisky, firearms, property that is unsafe or unsanitary, or otherwise a nuisance, etc.

In *Mugler* v. *Kansas*, 123 U.S. 623, it was argued that a Kansas prohibition statute constituted a taking of private property without just compensation, as required by the due process clause of the 14th Amendment. The Court, at pages 668-9, said:

> As already stated, the present case must be governed by principles that do not involve the power of eminent domain, in the exercise of which property may not be taken for public use without compensation. A prohibition * * * upon the use of property for purposes that are declared, by valid legislation, to be injurious to the health, morals, or safety of the community, cannot, in any just sense, be deemed a taking or an appropriation of property for the public benefit. * * * The power which the states have of prohibiting such use by individuals of their property as will be prejudicial to the health, the morals, or the safety of the public, is not—and, consistently with the existence and safety of organized society, cannot be—burdened with the condition that the State must compensate such individual owners for pecuniary losses they may sustain, by reason of their not being permitted, by a noxious use of their property, to inflict injury upon the community. The exercise of the police power by the destruction of property which is itself a public nuisance, or the prohibition of its use in a particular way, whereby its value becomes depreciated, is very different from taking property for public use, or from depriving a person of his property without due process of law. In the one case,

a nuisance only is abated; in the other, unoffending property is taken away from an innocent owner.

See also *Union Bridge Co.* v. *United States*, 204 U.S. 364 (alterations of a bridge over a navigable stream); *Samuels* v. *McCurdy*, 267 U.S. 188 (making unlawful the possession of liquor purchased before the passage of the 18th Amendment); *Corneli* v. *Moore*, 257 U.S. 491 (prohibiting the transfer of liquor from the Government-bonded warehouse to the dwelling of the owner); *United States* v. *Caltex*, 344 U.S. 149 (destruction of property to prevent capture by the enemy); and *United States* v. *Central Eureka Mining Co.*, 357 U.S. 155 (a prohibition on the mining of gold during a war emergency). In none of these cases was it held that there was a requisition or condemnation of the property.

Plaintiffs say that the term "requisition or condemnation" as used in the Act means something more than the exercise of the power of eminent domain. We do not think it does. It seems clear to us that the words mean the taking or the threat of taking property by some public or quasi-public corporation—by some instrumentality that has the power to do so against the will of the owner, and for the use of the taker. That is the common, well-recognized meaning of those words and there is nothing to indicate that Congress used them in any other sense. Plaintiffs were required to dispose of their property, but the United States did not take it, nor did it prevent plaintiffs from getting for it its full market value at the time of the taking.

Section 112(f) of the Internal Revenue Code of 1939 uses the same words as those with which we are concerned. Such a provision first appeared in the Revenue Act of 1921. They were used to take care of situations resulting from the sinking of ships by submarines or their requisition by the Government for its use, as is shown by the letter of the Secre-

tary of the Treasury to the Committee on Ways and Means when the Revenue Act of 1918 was under consideration. It read, in part:

> During the war, in the case of property requisitioned for war purposes by the Government and property lost or destroyed in whole or in part, through war hazards, especially in the case of ships, it happened that at the time of the requisition or loss the market value of such ships was considerably increased over the cost * * *, and that in practically no case would the taxpayer have been willing to sell the property for its appraised value at the time of requisition or loss.
>
> To require the taxpayer to pay income and war profits and excess profits taxes upon the difference between the cost * * * and the compensation received at the time of requisition or loss would have been to take such a large proportion of the amount received for the vessel that, although the owner desired to replace the same, the taking of the tax by the Government would have made it impossible in practically every instance.

This shows that when Congress set about to take care of situations arising from the involuntary conversion of property by destruction or the taking of it for governmental use, it used the words with which we are here concerned. This tends to support the view that Congress had in mind requisitions or condemnations under the power of eminent domain.

The Tax Court so understood these words in 112(f). See *Dear Publication & Radio, Inc.* v. *Commissioner*, 31 T.C. 1168. In a previous case, in *Credit and Investment Corp.* v. *Commissioner*, 47 B.T.A. 673, it also had so construed the words.

In the *Dear Publication & Radio* case there was involved a New Jersey statute which required the dissolution of a

corporation in case of a deadlock among the management. In order to prevent this dissolution, the taxpayer sold his stock in the corporation. He claimed that this was an involuntary conversion through requisition or condemnation or the threat thereof within the meaning of 112(f). The Court of Appeals for the Third Circuit affirmed the Tax Court, holding that a sale under such conditions was not an involuntary conversion "under threat or imminence of requisition or condemnation." *Dear Publication & Radio, Inc.* v. *Commissioner*, 274 F.2d 656.

Plaintiffs say that the threat to resort to court for the appointment of a receiver, in case of failure to comply with the Commisison's order, was a threat to requisition its property; but, manifestly, this is not so. The purpose of the appointment of a receiver was to force compliance with the Commission's order, not to take the property for public use. The order was issued to carry out the mandate of an Act passed pursuant to the power of Congress to regulate commerce, not under the power of eminent domain. Once the order was complied with and assurances given of future compliance, the property, or the amount received from a sale of any part of it, would be returned to its owner. No part of it was or would be taken for public use. None of it was requisitioned or condemned.

It results that plaintiffs' petition must be dismissed.

It is so ordered.

LITTLETON, *Judge (Ret.)*: LARAMORE, *Judge*: MADDEN, *Judge*; and JONES, *Chief Judge*, concur.